CORPORATE DIVIDEND PRACTICES – A STUDY WITH SPECIAL REFERENCE TO SOFTWARE COMPANIES

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Abstract

Dividend policy involves extremely important financial decisions which serve as a basis of numerous theories. However, these theories have been developed in different fields, and according to some evidence this policy remains a kind of dilemma in the financial cycles of corporations. The dividend is one form of profit sharing by a firm. Business Enterprises declare the dividends to reward the sacrifices of equity shareholders. Dividend is used as a tool to reduce the agency cost associated with the capital funds. Many factors affect the dividend policies of enterprises in India. These considerations differ across time and industry. The Dividend Decision, in corporate finance, is a decision made by the directors of a company about the amount and timing of any cash payments made to the company's stockholders. The Dividend Decision is an important part of the present day corporate world. The Dividend decision is an important one for the firm as it may influence its capital structure and stock price. In addition, the Dividend decision may determine the amount of taxation that stockholders pay. A Dividend decisions are an important aspect of corporate financial policy since they can have an effect on the availability as well as the cost of capital. The Lintner proposition which asserts that the corporate management maintains a constant target payout ratio has been the most influential. However, the concepts of primary of dividend decisions as well as the reasons for it are not unambiguously defined. There is a variety of theories which attempt to rationalize the observed secular constancy of the dividend payout ratio. The present study examines the corporate dividend practices in software companies and study based on secondary sources of data collection.

Keywords*: Financial Decisions, Financial Cycles, Capital Funds, Payout Ratio and Corporate Finance.*

Introduction

Corporate dividend policy has long been an issue of interest in the financial literature and, despite the vast research on the topic, it remains an open subject. Dividend policy is the set of guidelines a company uses to decide how much of its earnings it will pay out to shareholders. Some evidence suggests that investors are not concerned with a company's dividend policy since they can sell a portion of their portfolio of equities if they want cash. This evidence is called the "dividend irrelevance theory," and it essentially indicates that an issuance of dividends should have little to no impact on stock price. That being said, many companies do pay dividends.

Business Enterprises address the ultimate objective of maximizing the wealth of stakeholders in the long run. The dividend is one form of rewarding the equity shareholders. A portion of the annual accounting profit of a business enterprise is normally declared and paid as dividend to the equity shareholders. The dividend is disbursed normally in the form of cash dividend, special dividend, bonus share, stock split, buyback of shares and dividend warrants. The dividend decision of a firm is influenced by various factors such as the size of firm, profitability which differ across time and industry. The dividend payout is considered as the means to reduce the agency cost and it can also be used to reduce the cash flow that the managers can use at their discretion.

The study of dividend determinants of corporate enterprises is helpful for the equity investors to take well informed investment decisions. It will be useful for the corporate enterprises to become more equitable, fair and transparent in terms of Accounting, Auditing and Reporting Practices in sync with the Global Standards. It is beneficial for the corporate enterprises to enhance the financial integrity of their organizations and to protect the interests of all stakeholders including creditors, customers, and investors, regulating bodies, the suppliers and the economy as a whole[1].

Objectives of the Study

The present study aims with following objectives:

1. To know about the dividend practices in Software Companies
2. To know the investors' preferences on dividend yield and dividend trend
3. To study the monitoring and dividend clienteles and dividend yields across sectors and regions
4. To have an knowledge on global survey of corporate financial policies & practices

Review of Literatures

Kanwal Anil and Sujata Kapoor[2] (2008) found that the firm's profits and liquidity were positively related while corporate tax rates were negatively associated with the dividend payout. Miller and Modigliani (1961) felt that the dividend policy is irrelevant in measuring the current valuation of equity shares in the presence of irrational assumptions like market perfections, zero transaction costs, perfect certainty and indifferent behavior of investors.

La Porta Rafael, Lopez de Silanes Florencio, Shleifer Andrei and Vishny Robert[3] (2000) pointed out that the legal system dominated the ownership structure of corporate enterprises. The companies, with widely dispersed shareholdings, earned high rate of Return on Investments (ROI). The study found that the Agency Cost could be mitigated by

[1] *Fernando A. C, 2009, "Corporate Governance – Principles, Policies and Practices", Dorling Kindersley (India) Pvt. Ltd., New Delhi*

[2] *Kanwal Anil and Sujata Kapoor, 2008, "Determinants of Dividend Payout Ratios – A Study of Indian Information Technology Sector", International Journal of Finance and Economics, 15; 63-71.*

[3] *La Porta Rafael, Lopez de Silanes Florencio, Shleifer Andrei and Vishny Robert, 2000, "Agency Problems and Dividend policies around the world", Journal of Finance, 55; 1-33.*

the professionalized institutional structure and management of business enterprises. The results of LLSV (2000) on a cross section study of 4,000 companies from 33 countries with different levels of minority shareholder rights support the outcome agency model of dividends. Accordingly, it is reasonable that outside minority shareholders prefer dividends over retained earnings. In line with that, Bebczuk (2005) states that the testable prediction of this theoretical body is that dividend disbursements will be the higher the better are the corporate governance practices in the company. In this case corporate governments reflect the power of minority shareholders in the company.

Dividend Practices in Software Companies

The dividend policy of a firm becomes the choice of financial strategy when investment decisions are taken as given. It is also imperative to know whether the firm will go for internal or external source of financing for its investment project. There are a number of factors affecting the dividend policy decisions of a firm such as investor’s preference, earnings, investment opportunities; annual vs. target capital structure, flotation costs, signaling, stability & Government policies and taxation. In the presence of asymmetric information, signaling is one of the crucial factors that influence the market. Dividends may convey information about the company, so it suggests the possibility of its influence on the stock market. Paying large dividends reduces risk and thus influence stock price (Gordon, 1963) and is a proxy for the future earnings (Baskin, 1989) Baskin (1989) takes a slightly different approach and examines the influence of dividend policy on stock price volatility, as opposed to that on stock returns. He advances four basic models which relate dividends to stock price risk. He terms these as the duration effect, the rate of return effect, the arbitrage pricing effect and the informational effect. The difficulty in many empirical works examining the linkage between dividend policy and stock volatility or returns lies in the setting up of adequate control over the factors that influence both. For example, the accounting system generates information on several relationships that are considered by many to be measures of risk. Baskin (1989) suggests the use of the following control variables in testing the significance of the relationship between dividend yield and price volatility are operating earnings, the size of the firm, the level of debt, the payout ratio and the level of growth. So he had tried to explain the underlying linkage between dividend policies (dividend yield and dividend payout ratio) and stock price risk in his empirical work on USA. A number of theoretical mechanisms have been suggested that cause dividend yield and payout ratios to vary inversely with common stock volatility. As dividends can be cash dividends, stock dividends, stock splits & share repurchases, the question comes about the nature of the dividend & its impact on the share price and whether market is more volatile to high dividend yield share than normal share comes into the picture. There is a need to study the sensitivity of market to the nature of dividends.

The linkage between dividends & share price should be examined by controlling other factors which are responsible for affecting the dividend policy of a firm.

The table below lists the factors that are important in the choice between dividends and repurchases as a payout mechanism

Factor	Dominating Payout Form
Taxes	Depends
Conveying Information	Depends on time horizon
Management bonding	Dividends
Shareholder Rights	Depends on other factors
Investor preferences	Depends on preferences
Attracting monitors	Depends on other factors
Managing EPS	Repurchases
Changing capital structure	Depends on other factors
Residual policy	Depends on other factors

Investor Preferences

According to various “investor preference” arguments, investors favour one payout form over another for unknown reasons. It can thus be called a behavioural argument because there is no economic rationale behind these preferences. Companies cater to these preferences by choosing the payout method currently favoured by investors. For this argument to work it must be the case that share prices of firms that cater to investor preferences are higher than share prices of firms that do not (or managers believe this to be the case). Otherwise, there is no reason for a firm to adjust its payout policy. Given that the price differential is based on investor irrationality, this argument also relies on limits to relative value investing. If not, a relative value investor would simply sell short the shares of the firms that cater to investor demand and purchase shares of firms that do not. The price difference between the two sets of firms would be the profit for the relative value investor.

Dividend Trends

Year-End dividend payment for the fiscal year ended March 31, 2015: June 19, 2015 (As of June 19, 2015)

Fiscal Year	Annual Dividend per Share (Yen)			Stock History
		Interim	Year-End	
FY2015 (ending March 2016)	70 (Est.)	35 (Est.)	35 (Est.)	
FY2014 (ended March 2015)	65	30	35	
FY2013 (ended March 2014)	3,030	3,000	30	1:100 Stock Split (Oct. 2013)
FY2012 (ended March 2013)	6,000	3,000	3,000	
FY2011 (ended March 2012)	5,600	2,800	2,800	
FY2010 (ended March 2011)	5,200	2,600	2,600	
FY2009 (ended March 2010)	5,200	2,600	2,600	
FY2008 (ended March 2009)	4,800	2,400	2,400	
FY2007 (ended March 2008)	4,800	2,400	2,400	
FY2006 (ended March 2007)	4,000	2,000	2,000	
FY2005 (ended March 2006)	4,000	2,000	2,000	
FY2004 (ended March 2005)	2,000	1,000	1,000	
FY2003 (ended March 2004)	1,500	500	1,000 (Incl. 500-yen commemorative dividend)	
FY2002 (ended March 2003)	500	-	500	1:5 Stock Split (May 2002)
FY2001 (ended March 2002)	1,500	500	1,000 (Incl. 500-yen commemorative dividend)	
FY2000 (ended March 2001)	1,000	500	500	460,000 2nd Public Offering (Feb. 2001)
FY1999 (ended March 2000)	1,000	500	500 (Incl. 200-yen commemorative dividend)	1:5 Stock Split (Sep. 1999)
FY1998 (ended March 1999)	5,000	-	5,000 (Incl. 2,000-yen commemorative dividend)	327,000 Initial Public Offering (Oct. 1998)

Monitoring and Dividend Clienteles

Suppose that investors generally prefer returns in the form of capital gains, whether this is for tax reasons or not. However, suppose that a subset of investors prefer dividend income. Would it ever make sense for firms to cater to this small subset? Allen et al. (2000) argue that it could make sense if these investors are more skilled at monitoring the firm and its managers than other investors. In other words, firms cater to particular investors because these investors are better at assessing the performance of the company and taking action if necessary.

Managers might cater to these investors for at least two reasons:

- It may be a way for high quality managers to bond themselves and indicate that they are not afraid of being closely monitored
- The monitors may actually provide valuable advice to management, which enhances the value of the firm

Note that causality is different in the two explanations. The first explanation suggests that high quality firms are signalling quality by agreeing to be monitored. The second suggests that monitoring itself may enhance the value of the firm.

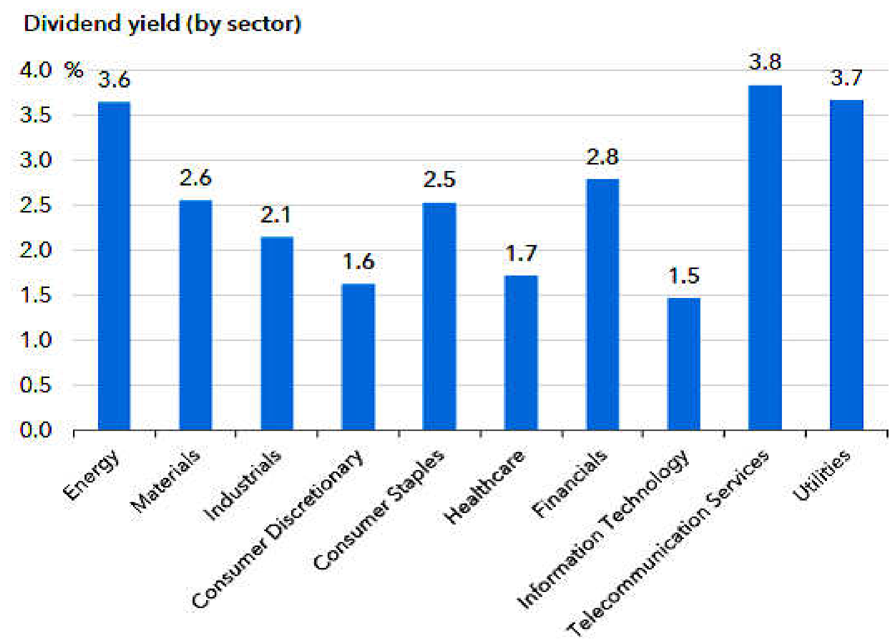
Managing EPS

Conducting a share repurchase right before the end of the firm's fiscal year is likely to have little effect on the overall earnings of the firm. However, the reduction in the number of shares outstanding will have an immediate impact on Earnings Per Share. If investors do not see through this, then the firm could, at least in the short run, increase its share price. Executives may also engage in this practice because their compensation contracts target certain levels or growth rates in EPS. Over time, the ability to repurchase shares strategically may allow the firm to deliver a pattern of EPS that is smoother (less volatile) than it would be otherwise. If the market values this reduction in volatility, value is created. It is important to establish that the arguments presented above are only valid if investors are not fully rational. Rational investors should not care about the volatility of individual shares because this volatility matters little in a portfolio context. They should also see through the fact that the increase in EPS achieved through a share repurchase is also temporary. The only reason why the ability to smooth or manage EPS through share repurchase may have true economic consequences, is if the firm has entered into contracts that take into account EPS or rely on EPS to draw inferences.

Analysis of dividend trends for a large sample of stocks traded on the NSE and BSE indicate that the percentage of companies paying dividends has declined from 60.5 percent in 1990 to 32.1 percent in 2001 and that only a few firms have consistently paid the same levels of dividends.

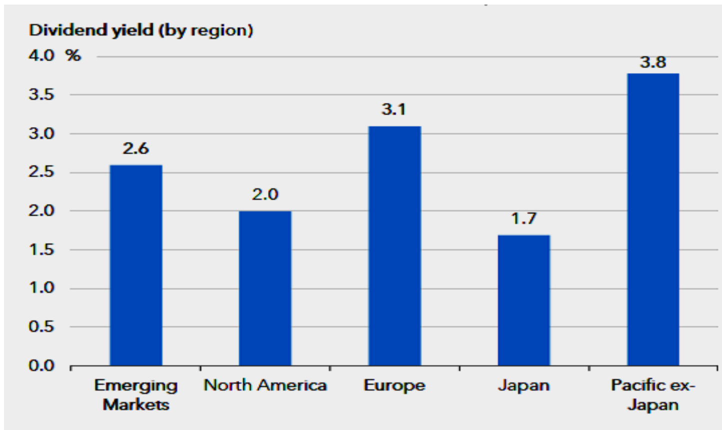
Dividend Yields Vary Across Sectors and Regions

Elsewhere, the information technology sector recorded the lowest yield. That is not immediately surprising the sector is usually known for companies that prefer to invest in growth than pay dividends. But over the years, as these companies have become more cash generative, they are also acknowledging dividends' importance to shareholders. Apple's decision in 2012 to resume dividend payments after a break of more than 15 years was a symbol of that mindset change.



Source: *MSCI ACWI, as at 27th Feb. 2015, Rimes*

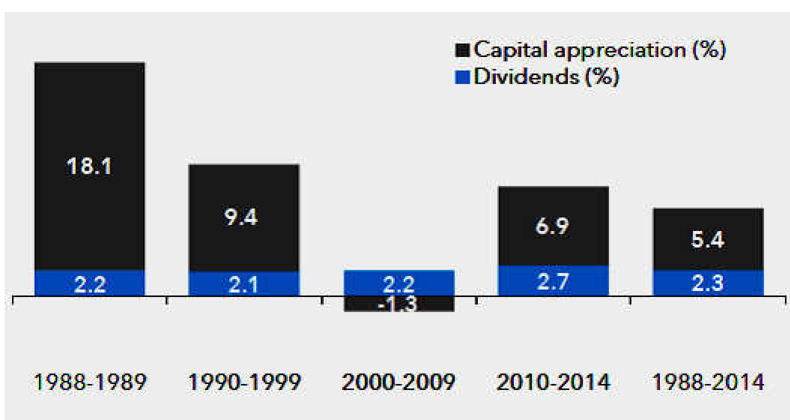
Companies in different regions also tend to regard dividends differently. Pacific ex-Japan had the highest dividend yield, followed by Europe. Although many investors associate emerging markets with growth stocks, the majority of companies in the MSCI Emerging Markets Index paid dividends and delivered a higher yield compared with companies in North America and Japan.



Source: *MSCI Emerging Markets Index, MSCI North America Index, MSCI Europe Index, MSCI Japan Index, MSCI Pacific ex-Japan Index, as at 27th Feb. 2015, Rimes.*

Dividends have been a significant part of total returns

Over the years, dividends have been an important contributor totals returns, though they have certainly been more prominent in some periods than others. Unsteady economic growth and other headwinds may cast doubts over the direction of dividends in the near term, but the longer-term outlook is bright. Many companies are in sufficiently robust health to weather market uncertainties. And in some regions, companies are only just beginning to recognize the importance of dividends. But, uncovering high-quality companies that can grow their dividends over time requires nothing less than solid fundamental research.

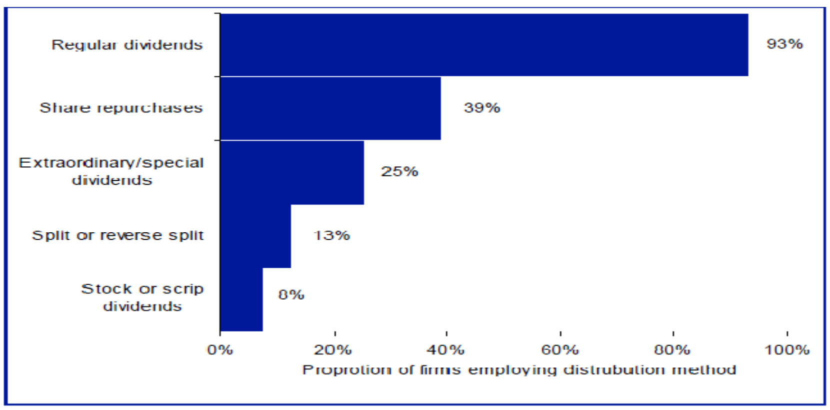


Source: MSCI, Rimes on 31st Dec. 2014.

Global Survey of Corporate Financial Policies & Practices *(Secondary Sources)*

The empirical evidence in this paper is drawn from a survey conducted during mid 2005 by Professor Henri Servaes of London Business School and Professor Peter Tufano of Harvard Business School. The project was originated and sponsored by Deutsche Bank AG with the Global Association of Risk Professionals (GARP) acting as secondary sponsor. 334 companies globally participated with responses distributed widely by geography and by industry.

Preferred Distribution Method



Q.1: "Over the last five years, have you done any of the following?" N=205

Factors Determining the Method of Distribution - Regional Ranking

Factors	Asia excluding Japan	Australia & New Zealand	Germany	Japan	Latin America	North America	Western Europe excluding Germany
Signalling	2	1	1	4	1	1	2
Flexibility in changing level of distribution	5	3	3	2	2	1	3
Tax efficiency of the alternative	3	5	2	5	3	4	1
Attractiveness to different investors	1	3	5	1	4	5	4
Accounting implications	4	1	4	3	4	3	5

***Source:** Secondary data*

Conclusion

A dividend policy is first known as a heavy factor in a company's stock value. However, more scholars are suggesting that corporate dividend policies do not matter and should not matter in a company's stock value. One of the central issues of corporate finance has been the dividend decision of a firm, which has always been studied in relation to a firm's financing and investment decisions. The corporate dividend practices of software companies and the value of dividend policies falls on investor decisions. While there are contrasting views of its usefulness, the most important factor is achieving the best bang-for-buck. The financial manager must take careful decisions on how the profit should be distributed among shareholders. It is very important and crucial part of the business concern, because these decisions are directly related with the value of the business concern and shareholder's wealth. Like financing decision and investment decision, dividend decision is also a major part of the financial manager. When the business concerns decide dividend policy, they have to consider certain factors such as retained earnings and the nature of shareholder of the business concern.

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